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TAGS: [EFIN](#) [ECON](#) [RS](#)
SUBJECT: PUTIN CALLS FOR RUSSIAN INVESTOR CLASS

Classified By: Ambassador John Beyrle, Reasons 1.4 (b/d).

Summary

¶1. (C) In a December 1 cabinet meeting, Prime Minister Putin voiced frustration over the country's reliance on foreign markets to fund domestic growth. He blamed foreign investors for driving down the market value of Russian firms. While Russia would not place restrictions on foreign capital, Putin insisted that Russia develop home-grown securities investors and stronger financial institutions. He also advocated a far-reaching FDIC-like insurance system, which would compensate investors who incurred losses. Putin's call for an investment insurance program seems unworkable and would likely carry an exorbitant price tag without being effective.
End Summary.

A Look Backward

¶2. (SBU) The December 1 presidium (core cabinet) meeting - much of which was televised on the evening news - focused on Russia's long-term financial market strategy. Prime Minister Putin chaired the meeting during which he expressed his dismay over the country's excessive dependence on foreign capital. Before the onset of the crisis, Russian firms had received the majority of their credit financing either directly from foreign lenders or as a result of foreign borrowing by Russian banks, Putin said. The same had been true for equity financing. When foreign capital left the country following the global liquidity squeeze, the GOR had been compelled to step in and provide needed financial resources.

¶3. (SBU) Putin deplored the steep fall in the value of Russia's stock markets, which he claimed was a result of this dependence on foreign capital. Without mentioning specifics, Putin said decisions about which Russian securities to buy and sell and at what price were being made outside the Russian Federation. In some cases foreign investors had driven the market capitalization of Russian firms far below the value of the firms' underlying assets. Putin said the GOR recognized that foreign capital had contributed to Russia's recent growth and had no plans to place restrictions on it. However, Russian equity values' being determined abroad was "ugly" and "unfair" and needed to be prevented in the future.

A Look Forward?

¶4. (SBU) Putin said the way to prevent this in the future was to turn Russia into an international financial center. This would result in a massive class of domestic investors and create powerful financial institutions with global reach. Among the steps Putin said the country needed to reach this objective were an insider trading law, simplifications of the tax and visa regimes for businesses, and a reduction in the costs of raising domestic capital and attracting foreign capital. He said the financial crisis represented an opportunity to achieve this goal and called on the GOR to submit draft legislation on these issues in the near future.

¶5. (SBU) Putin also called for the formation of a system that would guarantee domestic and foreign investors against losses in Russia's markets. The system would be similar to the Deposit Insurance Agency for retail bank deposits. Putin said this measure would help uphold investor rights, safeguarding them from fraud and market manipulation and other "unconscionable" actions by market participants.

Recognizing the Problem is Not Russia's Problem

¶6. (C) Reactions to the speech from financial industry insiders were largely negative. Alfa Bank Chief Economist Natalya Orlova, for instance, told us that Putin's analysis of developments in the stock market had been "myopic." Orlova said Putin had, apparently, not recognized that stock purchasing decisions incorporated a variety of factors and were not based solely on the value of a company's assets. She said foreign investors might actually have underestimated the negative effect of certain Russia-specific factors, such as the large role of the state in the economy and the GOR's use of \$4 billion in international reserves each week to support the ruble. If Russian investors dominated stock trading, valuations might be even lower, Orlova said.

¶7. (C) Orlova was even more critical of Putin's investment insurance system. She said it would not succeed in stabilizing markets if implemented but would be very expensive. In that regard, she noted that the budget was already facing a serious revenue shortfall in 2009 and that Finance Minister Kudrin had already said the Reserve Fund might need to be tapped to the tune of RUR 1 trillion (\$36 billion) in 2009 to make up the difference. She said the insurance system would blow a further hole in the budget that Russia could ill afford, especially for a program that would be so obviously open to abuse.

¶8. (C) Finally, Orlova said Putin's plans to foster a dynamic investor base and strong financial institutions sounded great in theory. However, the GOR had spent years unsuccessfully encouraging Russians to invest in domestic stocks and bonds. The problem, Orlova said, was a basic lack of trust that was fueled by widespread official corruption and the state's excessive and opaque role in the economy. Until these were addressed, Russia would not develop a strong domestic investor class.

Comment

¶9. (C) Putin's diatribe against foreign investors is yet another sign of GOR anger over a crisis officials feel is not Russia's fault but whose effects they can do little to mitigate. In this context, the investment insurance program is the latest effort in a series of increasingly desperate efforts to find something that can restore confidence to Russian markets. We would agree with Orlova, however, that the program, if implemented, would not stabilize the markets but could prove prohibitively expensive, especially with Russian insiders looking for yet another government handout. Putin's comments are the latest indication that Russian leaders remain in denial about the extent to which the

Russian economy is linked inextricably with global economic trends. After all, much of the steep rise in the value of Russian companies during the last five years was the result of inflows of the same foreign capital whose outflow now criticizes. End Comment.
BEYRLE